

INTERNAL-REVENUE LAWS RELATING TO DISTILLED  
SPIRITS, ETC.

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Mr. EVANS, from the Committee on Ways and Means, submitted the  
following

REPORT.

[To accompany H. R. 10253.]

The Committee on Ways and Means having carefully considered the bill (H. R. 10253) to amend the internal-revenue laws relating to distilled spirits, and for other purposes, recommend that the same be passed.

This bill is the final outcome of the consideration which the committee have given to certain phases of the internal-revenue laws relating to distilled spirits, and to which several bills introduced at the present session have directed attention.

In their efforts to reach a proper conclusion the committee have been greatly assisted by the Internal-Revenue Office.

Some of the bills referred to proposed to reduce to a greater or less extent the rate of tax on distilled spirits, but while the present rate is certainly high, and in the estimation of many extremely so, being at least 700 per cent on the original cost of production of the finest and most expensive spirits, and ranging from that to about 1,200 per cent on the cost of producing the cheapest grades, yet in view of the present war conditions, and the necessity of now imposing taxation upon many other articles, the committee have not considered it wise or expedient at this time to favor the proposition to lower the tax rate on spirits, although in his carefully prepared letter of May 5, 1897, addressed to the President of the Senate in reply to a resolution of that body (Senate

Doc. No. 72, Fifty-fifth Congress, first session), the present Secretary of the Treasury used the following language:

Third. What rate of tax will, in the judgment of the Secretary, produce the greatest amount of revenue consistent with the protection of the honest manufacturer and dealers?

In considering this question I submit the following table, which shows the revenue-producing results under the several rates of taxation on distilled spirits since the establishment of the present internal-revenue system:

*Consumption per capita of distilled spirits from materials other than fruit, and tax thereon and revenue therefrom.*

Year.	Per cent of tax.	Population.	Aggregate of population.	Aggregate gallons consumed.	Per capita consumed.	Revenue.
1860.....	None.	31,443,321	31,443,321	83,904,285	2.86	None.
1864.....	\$0.20	34,046,000	34,046,000	85,295,393	2.57	\$17,059,792
1865.....	2.00	34,748,000	125,575,875	37,979,104	.30	75,958,208
1866.....		35,469,000				
1867.....		36,211,000				
1868.....		36,973,000				
1869.....	.50	37,756,000	154,652,000	278,099,810	1.79	139,049,905
1870.....		38,558,000				
1871.....		39,555,000				
1872.....		40,596,000				
1873.....	.70	41,677,000	102,000,000	168,444,000	1.65	117,900,800
1874.....		42,796,000				
1875.....		43,951,000				
1876.....		43,951,000				
1877.....		45,137,000				
1878.....		46,353,000				
1879.....		47,998,000				
1880.....		48,866,000				
1881.....		50,155,783				
1882.....		51,316,000				
1883.....		52,495,000				
1884.....		53,693,000				
1885.....	.90	54,911,000	1,191,336,832	1,412,997,777	1.27	1,271,697,997
1886.....		56,148,000				
1887.....		57,404,000				
1888.....		58,680,000				
1889.....		59,974,000				
1890.....		61,289,000				
1891.....		62,622,000				
1892.....		63,975,000				
1893.....		65,403,000				
1894.....		66,826,000				
1895.....		68,275,000				
1896.....		69,753,000				
1897.....	1.10	71,263,000	110,615,275	115,104,612	.95	121,676,802
1898.....		71,263,000				

This table would indicate that the highest revenue-producing rate was 70 cents per gallon.

That the condition of the distilled spirits business is bad, and that it is such as will not yield to the United States the best and most satisfactory results in revenue, and certainly not such as it would yield in a healthy condition, are facts which are not only admitted by all who are acquainted with the subject, but which are demonstrated by the official figures, which will presently follow. Of course the interest of the United States in the subject is that of revenue only, and it would be a short-sighted policy for the Government, by unwise or oppressive legislation, to crush out the energetic men who have invested immense sums in a business which of late years has been very much more profitable to the Government than it has been to them. That disaster is impending over the business, and that such a result will most injuriously affect the revenues, is apparent from the great falling off in production since the pres-

ent law went into effect. The quantities of spirits produced in each year from 1890 to 1897, inclusive, are as follows:

*Statement of the production of distilled spirits in the United States, as shown by the returns to the office of the Commissioner of Internal Revenue from July 1, 1890, to June 30, 1897.*

Fiscal year ended June 30—	Spirits warehoused.					
	Fruit brandies.	Bourbon whisky.	Rye whisky.	Alcohol.	Rum.	Gin.
	Gallons.	Gallons.	Gallons.	Gallons.	Gallons.	Gallons.
1890.....	1,137,649	32,474,784	13,355,577	11,354,448	1,657,808	1,202,940
1891.....	1,223,725	29,931,415	14,345,389	12,260,821	1,784,312	1,293,874
1892.....	2,044,893	29,017,797	13,436,827	14,490,987	1,956,318	1,338,617
1893.....	1,250,276	40,835,873	16,702,240	12,250,380	2,106,765	1,424,490
1894.....	1,330,289	15,518,349	10,026,544	10,570,070	1,864,595	1,287,977
1895.....	906,359	18,717,153	12,321,543	8,819,923	1,777,083	1,176,669
1896.....	1,284,857	16,935,862	9,153,066	9,960,301	1,490,228	1,098,376
1897.....	620,362	6,113,726	4,269,220	9,503,353	1,294,157	1,159,314

The totals are as follows:

Fiscal year.	Quantity (taxable gallons).	Fiscal year.	Quantity (taxable gallons).
1890.....	111,101,738	1894.....	92,153,651
1891.....	117,767,101	1895.....	81,909,771
1892.....	118,436,506	1896.....	89,992,555
1893.....	131,010,330	1897.....	64,279,074

As further showing the condition of the business and its effect upon the revenue, the following official figures are given:

*Quantity, in taxable gallons, of spirits produced and deposited in distillery warehouses and the quantity withdrawn from such warehouses, tax paid, for the periods stated.*

Deposited during 30 months—		Gallons.
Ended August 31, 1894.....		277,127,809.8
Beginning September 1, 1894.....		194,038,705.5
Falling off in production during last 30 months.....		83,089,104.3
Withdrawn, tax paid, during 30 months—		
Ended August 31, 1894.....		254,192,712.9
Beginning September 1, 1894.....		151,346,340.6
Falling off in tax-paid withdrawals during last 30 months...		102,846,372.3
Receipts from distilled spirits during the 30 months—		
Ended August 31, 1894.....	\$231,182,893.06	
Beginning September 1, 1894.....	164,151,439.59	
Falling off in receipts during 30 months, from September 1, 1894	67,031,453.47	
Receipts from tobacco during the 30 months—		
Ended August 31, 1894.....	75,985,779.20	
Beginning September 1, 1894.....	75,016,527.63	
Falling off in receipts during 30 months, from September 1, 1894	969,251.57	
Receipts from fermented liquors during the 30 months—		
Ended August 31, 1894.....	79,914,123.44	
Beginning September 1, 1894.....	78,327,398.48	
Falling off in receipts during 30 months, from September 1, 1894.	1,586,724.96	
Percentage loss in receipts from—		
Distilled spirits.....		16.95
Tobacco.....		.64
Fermented liquors.....		1

It will be observed that while the loss during the second period in receipts from fermented liquors was only 1 per cent, and from tobacco less than 1 per cent, the decrease in receipts from distilled spirits was nearly 17 per cent, notwithstanding the increase of the rate of tax on spirits of more than 25 per cent.

These figures, per se, demonstrate the danger which, in the near future, will threaten as well the manufacturer of spirits as the revenues of the country, for without the production of the spirits the revenues are lost, and unless there is left some margin or prospect of profit to the manufacturer he can not continue the business. If it be the policy to paralyze this great revenue producer, all that is needed is to leave the law as it is and the work will be effectually done, but as the revenue is greatly needed and as it can come from no other source which will be so little felt, the committee have deemed it wise to recommend that the relief offered by this bill should be promptly afforded.

The present anomalous condition of the law respecting the time which distilled spirits may remain in bond in order to perfect their manufacture into the best article, and respecting the maximum allowance which may be made for those losses from evaporation or leakage, which are necessary incidents to that manufacture, has worked very great injustice and injury to the trade without any advantage to the Government.

Under the act of 1894 the tax rate was increased from 90 cents per gallon to \$1.10—a raise of 20 per cent on the rate and an increase of over 130 per cent on the original cost of production of the subject of the taxation. As some compensation for this great increase, the same act extended the bonded period from three years to eight years, but only extended the period during which there might be an allowance made for losses by evaporation, etc., and which will hereafter be called the outage period, from three years to four years, although that evaporation was certain to continue during the whole eight-year-bonded-period, however carefully the spirits may have been warehoused and guarded, because it is a continuous work of nature.

The bonded period was given upon the ground that it takes the time to perfect the manufacture of the goods. Yet under the present law the spirits lost beyond the possibility of recovery by the evaporation, which takes place during the last four years of the bonded period, must pay the tax precisely as if still on hand, ready to go into the market. This change of law by the act of 1894 was a new and untried experiment. No one could or did foresee how it would work. The results of having a bonded period of eight years and an outage period of only four years have not only been disappointing, but threaten, as will be seen hereafter, serious disaster to the trade and to the revenues.

As correctly and practically applied to the subject of the taxation the law is wholly incongruous and unsuitable.

The committee has knowledge of no fact which justifies having a bonded period of one length of time and an outage period of another. The two should correspond. Practical experience has fully shown that the two periods should be coincident and coextensive, and the principal object of this bill is to accomplish that result.

The most startling and unexpected effect of this condition of the law is the unquestioned fact that it discriminates against spirits more than four years old, and in so doing ruinously diminishes their value. Although those spirits are older and better and intrinsically more valuable, yet because of that discrimination they can not be sold in the



market for as much as those of the same make and brand which are less than four years old, and this for the reason that the purchaser knows in one case what his allowance for outage will be when he shall come to take his goods out of bond, and in the other he does not.

Hence the fact was clearly proved to the committee that fine whiskies distilled in 1892 and 1893 can not be sold in the market for as much by 10 to 20 cents per gallon as the whiskies of the same make manufactured in 1895. The productions of the years just previous to 1894, as the figures already given show, were very large, and this immense depreciation in their value by reason of this incongruous state of the law threatens such overwhelming disasters to all those in interest that it can not escape our attention. An average depreciation of 15 cents per gallon on the combined product of fine whiskies for the four years prior to 1894 would be a loss so great that no trade could stand it.

The only way to prevent this gross injustice to the citizen is to enact this bill into law. If it is not done, the only remaining refuge lies in the exportation of the spirits to avoid payment of the tax—a result which, while only partially relieving the distress of the citizen, in no way benefits the United States, nor saves to it any of the taxes exportation is necessarily made to avoid.

The unwisdom and injustice of driving the citizen to this mode of relief from bad laws will be further noticed in this report.

It was, indeed, considered by several of the committee that the proper and logical legislation for the emergency, and indeed for all time, was to provide for an indefinite and unlimited bonded period, with allowances for all evaporations naturally occurring without the fraud or negligence of the owner during the whole time the spirits remained in bond, requiring the tax to be paid only upon such of the spirits as went into consumption, thus taxing consumption instead of manufacture.

Our earliest internal-revenue enactment (act of 1862) provided for the payment of the tax on distilled spirits only when they were sold for consumption. That is the law now as to all other subjects of internal-revenue taxation, such as tobacco, cigars, beer, etc.

Justice would seem to demand that no tax should be levied on what can never be sold for consumption. If every gallon of spirits on which the tax is paid is sold, and the purchase price paid by a consumer, the distiller or dealer has no cause of complaint, for in that case an equitable distribution of burdens arranges itself by the laws of trade; but if the tax is exacted on what has previously evaporated and gone into the air, the owner is out just that much without the possibility of recovery, and equally without the possibility of ever getting a price for it. Other countries do not tax what is never sold. The English distillers and the French distillers put their spirits into docks or warehouses, and they remain there indefinitely untaxed until they are sold, and then taxed only on what remains. The injustice of taxing evaporation has long been recognized by those of our laws which partially mitigated it.

Indeed, if the rule were once established that the tax should be paid only on what goes into consumption, all the uncertainty and injustice now complained of, and which tends periodically to prostrate the trade, would be removed and the legitimate consumption of spirits per annum would still measure the amount of revenue collected. It is error to suppose that anything but consumption ordinarily measures the amount of revenue obtained from distilled spirits. If there are materially more spirits in warehouses than the demands for consumption will justify

paying taxes on, it will not be done. On the contrary, the spirits will and necessarily must be exported, for no man can afford to pay \$1.10 per gallon tax on spirits and lay them aside to wait for a purchaser not reasonably expected soon to appear. He will either export the spirits or importune Congress for temporary relief. Recurring periods of such importunities, and the troubles that provoked them, have been the causes of many incongruities and difficulties in our system which do not exist in those of other countries.

Pending the committee's consideration of the subject the present Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, has expressed himself to the committee upon one of the bills before them in this language:

With reference to the indefinite extension of the bonded period, intended to be secured by the form of bond prescribed, I would state that these provisions of the bill meet with my full approval. In my opinion the same rule of taxation that applies to all other products subject to internal-revenue tax should apply to distilled spirits—that is to say, the tax should be levied only upon the article withdrawn from the premises of the manufacturer for consumption or sale. The sooner such a law is passed the sooner will Congress be relieved from solicitations to pass bills offered from time to time to afford temporary relief. It needs no argument to show that any legislation which interferes with the operation of the natural law of supply and demand will prove irksome, not to say destructive, to any business so interfered with. The internal-revenue laws which require that distilled spirits shall be thrown upon the domestic market at a certain time, without regard to the demand which may or may not exist at that time, and without regard to the quantity actually delivered at that time, introduce such elements into the business problem as must often render it one of difficult solution.

Some of the committee have not coincided with these general views, but all agree that there is an urgent necessity for the relief finally agreed upon in the bill now reported as being a wise adjustment of those differences of opinion and as being well adapted to existing conditions.

In order to accomplish this result the first section of the bill reduces the bonded period from seven years to eight years, and the second section increases the outages period from four years to seven years, thus making the two periods coextensive; and it will not be overlooked that the provisions of section 2 of the bill carefully guard the interests of the United States against any fraud or neglect upon the part of the distiller by giving the Commissioner of Internal Revenue ample authority to collect the tax at once in such cases.

No relief would have been adequate, or would have met the requirements of the evil conditions existing, which did not provide for so extending the outage period as to reach the enormous production of 1893—a production which the tables already given show was the largest ever known.

It was proposed by some to lower the bonded period to six years, and extend the outage period accordingly, but besides the difficulty already mentioned regarding the enormous production of 1893 this proposition would have required spirits made in the fiscal year 1898-99 to be tax paid at the same time as those which had been made in 1896-97, and those made in 1899-1900 to be tax paid at the same time as those produced in 1897-98, thus requiring in each of the years 1904 and 1905 the payment of taxes on two years' product instead of one. It was regarded as most unwise to do this. But it is probable that the hardship of bringing the two years of 1898 and 1899 together in 1906, which might be great, will be mitigated by the parties in interest exercising wisdom in adjusting their production next year to this condition.

Fine whiskies (bourbons and ryes) can not be made without long storage and aging in wood. This aging is a necessary part of their manufacture, without which the spirits are not fit for use, and necessarily involves a considerable evaporation each year. Experience has shown that the natural rate is practically what is provided for in section 2 of the bill. If it is more in any case no allowance is made for it. If it is less in any case the tax is, of course, collected on all that remains. The allowances named in the bill are simply the maximum quantities, and do not exempt from taxation any spirits which are actually on hand at the time of withdrawal from warehouse.

It is true that many fraudulent counterfeits are put upon the market with liberal quantities of foreign ingredients put into them which pay no tax, and in that way the people drink much which they are not aware of, and to that extent the Government fails to get the full revenue it would get without the addition of this foreign matter, but this only adds to the burden of the manufacturer who adheres to the unadulterated article.

The aging of spirits is a very long and expensive process. The actual cash outlays for grain, labor, interest, insurance, etc., to say nothing of large plants, are very great, and profitable returns must be long waited for. When at last the long drawn-out period of aging has culminated the manufacturer may meet a prostrate or sensitive market to add to his burden, as is the case at this time.

In this respect he is very different from the maker of such merchandise as comes from a resort to adulterants. He is also very different from the manufacturer of such useful articles as alcohol, whose product is at its best when it runs from the still, and who can by immediate sales turn over his capital several times in one year, instead of waiting a good many years to turn it over once.

It has been shown as one reason for the passage of this bill that there are greatly more spirits in the warehouses than there is any demand for in the markets, and that all of them which are over four years old are rapidly depreciating in value, though getting better in quality, because the outage period does not now extend to them. But there is also another reason of great potency.

The Constitution of the United States, in clause 5, section 9, article 1, provides that "No tax or duty shall be laid on articles exported from any State."

This constitutional provision entitles every manufacturer at any time before the eight-year bonded period has expired, and before the tax is due, to export his product free of tax to some foreign country. He is driven, whether he wants to do so or not, to resort to this means of relief from the taxation if he can not find a purchaser. If he does not export it, our laws compel him to pay the tax of \$1.10 per gallon on all that has been evaporated after four years as well as on what is left. As he finds it impossible to pay the tax, he must export. If he chooses to do so, any number of years afterwards he may reimport the spirits, and when he does he only pays the tax on what is left and brought back. In this way he gets the benefit of an unlimited outage period, he pays on nothing which has evaporated, and by a laborious and roundabout, but indispensable, method he has obtained what this bill proposes to give him directly. In doing it he has paid largely to foreign laborers, foreign insurance and warehouse companies, and foreign ships, sums that should have been expended at home. Yet he has saved money by

it, as the following illustrative example, prepared by one well acquainted with the facts, will show:

[Illustration.]

*Cost of carrying whisky in United States distillery bonded warehouses for second term of four years under the existing law.*

	Per barrel.
Deficiency tax on evaporation, say 8 gallons, at \$1.10 .....	\$8.80
Insurance on basis of \$20 per barrel, at rate of $1\frac{1}{4}$ per cent per annum .....	1.00
Storage, four years, at 5 cents per barrel per month .....	2.40
Total .....	12.20

In comparison with—

*Cost of exporting to Bremen and carrying the same whisky for the second term of four years.*

	Per barrel.
Freights, including all other charges, from distillery to Bremen .....	\$2.25
Insurance, four years, at valuation of \$20 per barrel, at one-fifth of 1 per cent per annum .....	.16
Storage, four years, at 5 cents per barrel per month .....	2.40
a Return freight, at end of four years, to New York, Boston, or Baltimore ....	1.00
Total .....	5.81
Profit in exporting .....	6.39

The United States is not injured, but benefited, by aiding in keeping in healthy condition the trade from which it derives so much revenue, and it is not believed by the committee that there will be any loss of revenue from the passage of the proposed bill, but a considerable gain. The facts shown, combined with the right to export, will always limit the revenues to what is sold to go into consumption, and while the Government would not encourage consumption for the sake of revenue, it should not so hamper the operations of the laws of trade as to diminish it. A healthy trade will make a healthy, reliable revenue.

The first three sections of the bill relate to the matters already discussed.

The remaining sections are very strongly urged from the administrative standpoint by the Commissioner of Internal Revenue and the Secretary of the Treasury.

In the communication of the Secretary before referred to, he uses the following language:

Second. The effect of the greatly increased incentive to fraud furnished by the present high rate of tax is shown by the following facts:

Since the passage of the act of August 28, 1894, the number of illicit distilleries and of registered distilleries reported as operated illicitly has increased from 1,016 to 1,905. The number of arrests for violation of the internal-revenue laws has increased from 614 to 839.

The number of registered grain distilleries in the United States averages annually about 1,600. Of this number one-half is the average number operated during each year. Of the 1,600 a little less than half have registered daily capacity of 4 bushels or less, 470 have a registered capacity of more than 4 but less than 20 bushels, and 409 have a capacity of 20 bushels or more. The records in the office of the Commissioner of Internal Revenue show that since the increase of the tax a very large per cent of the smaller distilleries operate each year, and that the per cent of the larger distilleries operating during the year has decreased very considerably. In many sections of the country where these small distilleries are located it is found impracticable to sell forfeited spirits at a price equal to the amount of tax due on them. In these same sections it is found that distillers and dealers have agreed to furnish customers with distilled spirits at much less than the tax thereon, provided

a Reimported whiskies are usually sold as delivered in customs warehouse at above ports.



the purchasers agree to return the stamps intact or the barrel heads bearing the stamps. Other evidence is in the possession of the office of the Commissioner that in the sections where the small distilleries are operated spirits have been offered for sale at from 40 to 60 cents a gallon.

And the Commissioner in urging these provisions has furnished the committee with the following:

*Suggestions in support of the proposed measure requiring internal-revenue stamps to be affixed to certain packages containing distilled spirits not now required by law to be so stamped.*

Under the provisions of section 3295, Revised Statutes, as amended, all packages containing distilled spirits must have affixed thereto, before removal from the distiller's premises, stamps denoting payment of the tax thereon. The provisions of this section while furnishing a basis of the entire stamp system as to distilled spirits subject to tax, do not, in themselves, afford adequate protection against evasion of the tax; as, for instance, where spirits are illegally produced, or, after being duly accounted for by the distiller, are surreptitiously removed from his distillery premises.

With the view of preventing frauds of this character, the law (secs. 3320 and 3323, Rev. Stat., as amended) also requires packages containing spirits rectified or recasked on the premises of a rectifier or wholesale liquor dealer to have affixed thereto appropriate stamps after the spirits have been duly inspected and verified by an officer. These last-named provisions, however, apply only to casks or packages containing five wine gallons or more.

So far as it extends, this system of stamping and restamping distilled spirits affords reasonable protection to the Government against fraud, but by taking advantage of the limitation above referred to dishonest distillers are enabled to dispose of their illicit spirits in kegs, jugs, and other vessels containing less than five wine gallons, and with comparatively little risk of detection.

It is believed that the greater portion of the spirits illicitly produced in the United States are disposed of in the manner here described; and that the proposed measure, requiring the inspection and stamping of all packages containing not less than one wine gallon, not now required to be inspected and stamped, would not only tend to discourage illicit distilling, but would render it exceedingly difficult for dishonest distillers or dealers to dispose of any considerable quantity of spirits fraudulently removed from the distillery premises after having been duly deposited in a bonded warehouse. That frauds of the kind last referred to have been successfully committed, and with no small loss to the revenue, are clearly indicated by the large number of distillery warehouses which have of late years been destroyed by fire, and without any explainable reason other than for the purpose of concealing fraudulent removals of the spirits.

The adoption of this proposed measure is therefore urged, not only as a needed protection to the revenue, but as an act of justice to the honest distiller who is now forced to place his spirits, upon which a high rate of tax has been paid, in competition with spirits which the dishonest distiller is enabled, through a defect in the revenue law, to place on the market without payment of any tax whatever.

The last section of the bill is also insisted upon with great force by the internal-revenue office as being essential to the prevention of many frauds, and particularly that one which consists in shutting down a distillery if the revenue officer assigned to duty thereat does not happen to be agreeable to the distiller after he has traveled at his own expense to get there and must do the like to get back home.

Threats to resort to this course have been known to aid in frauds or else have worked great injustice to the officer. This section is designed to prevent both the one and the other result.

The general subject of this bill received great attention from the Committee on Ways and Means at the first session of the Forty-seventh Congress. Their report was written by the chairman, Mr. Kelley, of Pennsylvania, and the following extracts from it will show how well the views of that committee agreed with those of the present committee.

It was there, among many other things, said:

1. An indefinite extension of the time during which distilled spirits may remain in bond. Under the existing internal-revenue laws, distilled spirits is the only

article upon which the Government requires the tax to be paid before it is actually sold or removed for sale or consumption. In every other case the manufacturer keeps the article in his own possession and under his own exclusive control without the payment of any tax until he chooses to sell it or remove it for consumption or sale. The manufacturers of tobacco, snuff, cigars, beer, matches, perfumery, cosmetics, etc., are permitted to hold their goods until there is a consumptive demand for them, and pay the tax only when they sell. As we shall see hereafter, none of them are required to execute any bonds except as manufacturers, and the Government does not have the custody or control of their products as it does in the case of distilled spirits. In all these cases the tax is strictly upon consumption, and the manufacturer or owner is permitted to take advantage of favorable markets and avoid unfavorable ones to the same extent precisely as if there were no tax upon his goods. This is undoubtedly the true principle of excise taxation. While the Government is justifiable in exacting its revenue, it is not justifiable in attempting to control the trade in a legitimate article of commerce by forcing the owner either to sell at a loss on the original cost of production or to permanently invest the amount of the tax in addition to that cost.

In his annual report for the year 1879, the Commissioner of Internal Revenue, speaking of deficiency taxes upon spirits withdrawn for exportation, used the following language:

"The intention of the internal-revenue laws is to levy a tax of 90 cents a gallon upon spirits which are manufactured for and actually go into consumption in this country, and the tax in question is evidently not intended for revenue, but as a restrictive measure to prevent fraud."

There appears to be no sufficient reason why the single article of distilled spirits should be excepted from the general rule applied to all other taxable products. It can not be for the mere purpose of preventing fraud on the revenue, for certainly there is not as much danger of a fraudulent removal of the property without the payment of the tax in a case where the Government itself has actual possession and control of it as in the cases where it is left in the custody of the manufacturer or owner under a bond that he will pay the tax when he sells or removes it. And so far as the cost of governmental supervision is involved, it is exactly the same whether the spirits remain in the warehouse for one year or for an indefinite time. The compensation of the storekeeper is the same in amount in each case, and his constant attendance at the warehouse is required in both.

During the last fiscal year the consumption of distilled spirits in this country amounted to 67,372,575 gallons, the tax upon which was \$62,214,127.56. About 12,000,000 gallons of these spirits consisted of what is known as bourbon and rye whiskies. On the 1st day of March last there was remaining in bond about 84,000,000 gallons of spirits, upon which the tax would amount to about \$75,600,000. Much the greater part of this is bourbon and rye whisky. This vast accumulation of spirits in bond shows conclusively that the demand has not equalled the supply heretofore, and does not equal it now; and yet, under the existing law, the article is being forced out of the warehouse, and the owners are being compelled to advance the tax upon it before it can be sold.

In considering the question as to the propriety of extending the bonded period, it must be borne in mind that the Government can gain nothing whatever by forcing the owners to pay the tax before there is a demand for the article, for the obvious reason that the spirits thus forced out will constitute a stock in the market which must be consumed before another supply will be manufactured. If the Government were to compel the payment of the tax in every case immediately upon the production of the spirits, it would not in a series of years collect a dollar more than if it permitted the article to remain in the warehouse for an indefinite length of time. In the first case, no more would be manufactured within a year than could be sold and consumed; while, in the second, every gallon that could be sold or consumed would certainly be withdrawn from the warehouse during every year. In the end the result would be precisely the same, no matter which course is pursued by the Government. In the absence of fraudulent evasions of the tax, an actual diminution of the consumptive demand is the only thing that can possibly reduce the revenue. If all the spirits now in bond were to be immediately destroyed by fire or other casualty, the total amount of revenue would not be affected in the least, because its place would be at once supplied by a new product, and consumption would go on at the usual rate.

Suppose that the owners of the spirits now in bond shall be forced to pay 90 cents on the gallon and remove them from the warehouse before there is an actual demand for them in the market, they will, of course, be compelled to sell them at such prices as they can obtain. They can not afford to hold, for any considerable time, an article in which they have been compelled to invest so much beyond its intrinsic value, and the consequence will be that they will, necessarily, put prices

- down to the lowest possible point, and sell in competition with the inferior grades

of goods known as rectified and compounded spirits. To the extent that they compete with these other grades of spirits they necessarily prevent their consumption, and thus deprive the Government of the tax which those spirits would otherwise have yielded. It is manifest that the Treasury can gain nothing by a policy which forces the consumption of one kind of spirits instead of another, so long as both kinds pay the same rate of tax, and it is equally manifest that the manufacturers and dealers in rectified and compounded spirits would be greatly injured by such a policy.

The Government has possession of the spirits all the time, for, although the warehouse is erected by the distiller at his own expense, and is frequently a very costly building, the official storekeeper is required to keep it securely locked, and it is never allowed to be unlocked or opened except in his presence or in the presence of some person designated to act for him, and no articles are allowed to be received into it or delivered from it without an order or permit signed by the collector of the district. To secure the payment of the tax, therefore, the Government has, from the very beginning, the possession of all the property upon which the tax is imposed, and in case of default, by a failure to execute the bond or otherwise, nothing is necessary except to issue the proper process.

4. The bill proposes to extend the maximum allowance for leakage and evaporation until the end of eight years instead of three years, as now provided by the act of May 28, 1880. The law prescribing a maximum allowance for loss of spirits by leakage and evaporation has been in force nearly two years, and its operation has been, so far as the committee has been able to ascertain, satisfactory alike to the taxpayers and the revenue authorities. From July 20, 1868, to May 28, 1880, the owners of distilled spirits were required by law to pay a tax on the whole quantity entered in the warehouse, although a large part of it may have been actually lost by leakage and evaporation while in the custody of the Government officials.

The seventeenth section of the act last mentioned required the spirits to be regauged when withdrawn, and established a scale of maximum allowances. In its report upon that bill this committee used the following language:

"A brief review of the former legislation upon this subject will show that the principle upon which the eighteenth section of the present bill is based is not a new one in this country, except in so far as it limits the measure of allowance for evaporation and leakage, and a reference to the existing internal-revenue laws imposing taxes upon manufactured articles other than distilled spirits will show that the same just and equitable rule is still applied to all of them.

"The forty-first section of the act of July 1, 1862, provided that there should be paid on all spirits that might be distilled *and sold*, or removed for consumption or sale, of first proof, on and after the 1st day of August, 1862, a tax of twenty cents on each gallon, and that it should be paid by the owner, agent, or superintendent at the still or other vessel in which such spirits might be distilled at the time of rendering the accounts of spirituous liquors as required by the act (12 Stats., p. 447). The forty-fifth section of the same act required these accounts of the distiller to be rendered on the first, tenth, and twentieth days of each month (12 Stats., p. 448). Under this section, and others contained in that law, no duty was exacted on spirits in warehouse until there was a sale or removal for sale or consumption, and then only upon the number of gallons actually sold or removed.

"The twelfth section of the amendatory act of March 3, 1863, expressly authorized the Commissioner of Internal Revenue to make rules and regulations providing for deductions, on account of leakage, from the quantity of spirituous liquors subject to taxation under the act to which it was an amendment, not exceeding five per centum of the amount removed for sale; and it was provided that the deduction should be so adjusted in different parts of the United States as to be proportioned as nearly as practicable to the distances over which the manufacturer usually transferred such liquors for the wholesale thereof (12 Stats., p. 723). This, it will be observed, extended the principle a step further than the former law, and allowed for loss by leakage up to the time when the spirits had actually reached a market. Then followed the act of March 3, 1864, which returned to the principle of the act of 1862, and provided for a tax of sixty cents per gallon on all spirits that might be distilled and sold, or distilled and removed for consumption or sale, prior to the first day of the next July, and under this law the tax was imposed only on the spirits inspected out of the bonded warehouse when removed for sale or consumption.

"The act of June 30, 1864, increased the tax to \$1.50 per gallon, but made no change in the law as to allowances for evaporation and leakage; nor did the act of July 13, 1866, make any alteration of the law in this respect.

"Under these laws the tax was collected only on the quantity of spirits withdrawn

from the warehouse, as is shown by the official circulars and instructions issued from the office of the Commissioner. In a circular dated February 1, 1866, relating to bonded warehouse accounts, the collectors were directed to take credit 'for leakage and loss of spirits in transport, and which stand in the warehouse;' and in the same document it was provided that 'all actual loss of spirits or coal oil from leakage while in bonded warehouse will be allowed upon the proper certificate of the inspector;' and again, in the regulations of August 29, 1867, collectors were authorized to allow for leakage when it did not 'exceed 1 per cent per month for each month the merchandise has been in store.' Any loss in excess of that amount was to be allowed by the Commissioner himself instead of the collector.

"This was the state of the law and the practice under it until July 20, 1868, when Congress passed an act the fourth section of which declared that distilled spirits, spirits, alcohol, and alcoholic spirits, within the true intent and meaning of this act, is that substance known as ethyl alcohol, hydrated oxide of ethyl, or spirit of wine, which is commonly produced by the fermentation of grain, starch, molasses, or sugar, including all dilutions and mixtures of this substance, and that the tax should attach to this substance as soon as it is in existence as such, whether it be subsequently separated as pure or impure spirit, or be immediately or at some subsequent time transferred into any other substance, either in the process of original production or by any subsequent process (15 Stats., p. 126).

"The latter part of the section just mentioned, declaring that the tax 'shall attach to this substance as soon as it is in existence as such,' established for the first time in our legislation upon this subject a rule which makes a great discrimination against distilled spirits as to the manner of assessing internal-revenue taxes, and subjects the manufacturers of that article to the evil of which they now complain. According to the letter of this law, the tax attaches to the alcohol as it exists in the mash while in the fermenting tubs and before it has been separated from the other substances by the process of distillation; and in accordance with this interpretation the distiller is now in many instances actually required to pay tax upon the spirits which ought to have been produced from the mash, although the entire fermented matter may have been lost or destroyed by accident, and without fraud or negligence upon his part. This injustice is accomplished by assessing him as for a deficiency in not having produced 80 per cent of the surveyed capacity of his distillery as established by law.

"As already intimated, this rule, which makes the tax attach to the article as soon as it has an existence, and without reference to its sale or consumption or removal for sale or consumption, is exceptional in our legislation, and applies only to distilled spirits. In the case of tobacco and snuff, articles upon which many millions of dollars are annually collected, the law provides for the collection of a tax only upon the quantities 'manufactured and sold or removed for consumption and sale,' and the manufacturer is permitted to retain them in his own possession, without the payment of tax, for as long a time as his interests or fancy may dictate. The law is the same with regard to fermented liquors, cigars, medicines or preparations, perfumery, cosmetics, matches, wax tapers, playing cards, &c., &c. 'Manufactured and sold,' or 'made and sold, or removed for consumption or sale,' is the language of the law in all cases except distilled spirits; so that, with this single exception, the uniform and settled policy of the Government is to levy and collect internal-revenue taxes only upon manufactured articles which actually enter into consumption in this country, or are removed for consumption or sale in this country. During the present session, Congress, by the almost unanimous vote of both Houses, has reaffirmed this just policy by the passage of a bill allowing for loss by leakage while spirits are being transported to the port of shipment for exportation. The question of taxation upon exports could not affect the principle of that bill in the least, for the obvious reason that spirits actually lost by leakage or otherwise, and for which the allowance is to be made, can not be exported. It can only be vindicated upon the general ground that the citizen ought not to be compelled to pay an excise tax upon an article which can neither be sold nor consumed. This is undoubtedly the true policy, and is in strict accordance with the principles which underlie every just system of taxation; for upon no other theory or plan can the public burdens be properly distributed among those who ought rightfully to bear them. To tax the citizen upon a particular manufactured article simply because he has manufactured it, when, without fault or negligence of his, he can neither sell nor consume it, is to compel him to contribute more than his just proportion toward the support of the Government. When, however, the tax is collected upon the article sold or consumed everyone who purchases or in any way uses it necessarily pays his share of the duty.

"But the existing system, erroneous as it is in principle, has not even the merit of being uniform in its operation upon all classes of distillers. Notwithstanding the positive declaration of the act of July 20, 1868, that the tax shall attach to the spirits or alcohol as soon as it exists, there is another section of the law which, by construction, exempts a large class of distillers from the payment of a tax upon the whole



product of the grain used in their establishments and secures to them in every case an absolute allowance of from three to five per cent upon the entire quantity of spirits manufactured. These distillers complete the manufacture of their spirits and prepare it for the market by the process of continuous distillation; that is, they not only distill, but also rectify, purify, or refine the spirits. The ordinary distillers of high wines, rye, wheat, Bourbon, and other grain-flavored spirits are required by the law, as already stated, to convey the product of the still directly to the receiving cistern, from which it is drawn off by the gauger, in the presence of the storekeeper, into casks or packages, and immediately marked, branded, and gauged for taxation, without any allowance whatever for waste or absorption; but the continuous distiller is permitted to conduct the spirits produced by him from the still to a tub or cistern, and thence to the rectifying, purifying, or refining apparatus; and after it has been subjected to that additional process it is, for the first time, marked, branded, and gauged for taxation. From the time it leaves the still until it is gauged, after rectification and purification, there is a waste of from three to five per cent, or from one and a quarter to two gallons in each package of forty gallons. This gives to the continuous distiller a great advantage over others who manufacture only high wines, rye, wheat, or Bourbon spirits, because, when the latter pay a tax upon one hundred gallons as it comes from the still, he pays only upon ninety-five, or, at the most, ninety-seven gallons; and, besides, he has so refined and purified his article that it is ready to go on the market for immediate sale and consumption.

"The bill reported will place all distillers upon precisely the same footing in this respect by requiring all alike to pay the tax only upon the quantity sold or removed for consumption or sale, whether it be refined and prepared for the market by the mechanical process just mentioned or otherwise.

"It is a fact worthy of serious consideration in this connection, as tending to show the gross injustice resulting to domestic distillers, rectifiers, and dealers from the operation of the present law, that foreign traders may now purchase untaxed spirits in this country, or receive a drawback if the tax has been paid, with allowances for leakage between the warehouse and port of shipment, export it to a European or other port, keep it as many years as may be desirable to give it age and value, and then reimport it, have it gauged at the customs warehouse, and pay a tax of ninety cents per gallon upon the actual contents of each package. In this way the foreign dealer receives the benefit of the whole amount of evaporation and leakage, is exempt from the payment of interest upon the tax, and finally places the spirits, greatly increased in value by age, upon the American market in competition with the domestic distiller and dealer, who have been compelled to pay a tax upon the original quantity contained in the packages, and interest upon that tax besides. The whole cost of exporting the article to Liverpool and reimporting it into this country will not exceed the interest which the home producer or owner is compelled to pay on the tax, so that the foreign parties actually secure by the operation a clear advantage of from seven and a half to ten gallons on each package of forty gallons.

"This proceeding is authorized by section 2500 of the Revised Statutes, which provides that upon the reimportation of articles once exported, of the growth, product, or manufacture of the United States, upon which no internal revenue has been assessed or paid, or upon which such tax has been paid and refunded by allowance or drawback, there shall be levied, collected, and paid as duty equal to the tax imposed by the internal-revenue laws upon such articles. Under this statute and the decisions of the Treasury Department upon the subject, large quantities of domestic distilled spirits have already been sent from this country to Liverpool and to the Bermudas and other places, and, after remaining there in bond for a sufficient length of time to become purified and refined by age, have returned to our ports and paid the internal-revenue tax, with a full allowance for evaporation, leakage, and other loss."

The bill lately passed by the House does not increase the maximum allowances in any case, but merely extends the period for which they may be made from three years to eight years, and provides that after that time no allowance or deduction shall be made. The spirits are to be regauged as provided by the existing law, and if it shall be found that there has been a loss, without the fault or negligence of the distiller or owner, the tax is to be collected only on the quantity of distilled spirits contained in the cask or package at the time of the withdrawal; but in no case can the allowance exceed the quantity named in the bill, even though there may have been, in fact, a loss of double that quantity. On the other hand, if it shall be ascertained by the regauge that less than the quantity mentioned in the bill has been lost, the allowance can be made only for the actual deficiency.

Each package must be regauged and its contents accounted for separately, so that it is impossible, under any circumstances, for the owner or distiller to secure an allowance for more than is actually lost; while it may often happen, and, in fact, does often happen in the practical administration of the law, that he is compelled to pay the tax on spirits wholly lost by leakage and evaporation. For instance, if a number of packages have remained in the warehouses for two years and when

regauged it is ascertained that one of them has lost 2 gallons, another 3 gallons, and another 10 gallons, making an actual loss of 15 in all, yet the distiller or owner will, under the bill, receive an allowance of only 10½ gallons. That is, he will be allowed only the actual loss on the first two packages, and the maximum quantity, 5½ gallons, allowed by the bill on the third one.

It will be seen, therefore, that the question of average losses by leakage or evaporation does not enter into the consideration of this subject at all. There are no average allowances; the distiller or dealer who has five thousand packages in the warehouse is, in this respect, in precisely the same situation as the distiller or dealer who has only one package. Each separate package will be allowed for its own loss of contents, unless it exceeds the quantity prescribed by the bill for the time it has been in the warehouse; and if it should exceed that quantity the owner must pay the tax on the excess without regard to the fact that some other package has lost less than the maximum allowance.

In this connection it is proper to call attention to section 3293 of the Revised Statutes, as amended by the act of March 5, 1879, under which the Commissioner of Internal Revenue has the right, at any time when he believes that there has been an excessive loss of distilled spirits from any cask or package, to require the immediate withdrawal of such spirits from the warehouse and the payment of the tax upon the original quantity entered. So much of the section as relates to this subject is as follows:

"If it shall appear at any time that there has been a loss of distilled spirits from any cask or other package hereafter deposited in a distillery warehouse, other than the loss provided for in section three thousand two hundred and twenty-one of the Revised Statutes of the United States, which, in the opinion of the Commissioner of Internal Revenue, is excessive, he may instruct the collector of the district in which the loss has occurred to require the withdrawal from warehouse of such spirits, and to collect the tax accrued upon the original quantity of distilled spirits entered into the warehouse in such cask or package, together with the interest accrued thereon, if any, notwithstanding that the time specified in any bond given for the withdrawal of the spirits entered into warehouse in such cask or package has not expired. If the said tax and interest are not paid on demand, the collector shall report the amount due upon his next monthly list, and it shall be assessed and collected as other taxes are assessed and collected."

And the Commissioner of Internal Revenue at the time expressed his views on the subject as follows:

TREASURY DEPARTMENT, OFFICE OF INTERNAL REVENUE,  
*Washington, April 3, 1882.*

SIR: I acknowledge receipt of your valued favor of this instant in regard to House bill No. 5237, which provides for an extension of the bonded period upon distilled spirits.

The bill was prepared with great care, and in respect to its machinery I am satisfied it will work admirably. The principle of the bill is, I think, correct. Upon all manufactured articles upon which the internal-revenue tax is levied, except in the case of distilled spirits, the manufacturer or owner is not compelled to remove the same from the place of manufacture until he can find a sale for the product. This is so in respect to beer, tobacco, cigars, matches, etc. The extension of the bonded period to three years gave quite a stimulus to the manufacture of fine whiskies. On the 1st of March last there were 69,243,835 gallons in distillery warehouses in Kentucky, Pennsylvania, and Maryland. It seems to me unreasonable to suppose that these spirits can all be removed for consumption within the time now required by law. If the manufacturers and owners are required to pay the taxes within three years, I would expect to see such a decline in prices as would seriously embarrass many strong firms, probably cause many failures, and unfavorably affect other branches of business without any beneficial results to the Government. I think, upon this ground alone, the extension of the bonded period is entirely justifiable.

Very respectfully,

GREEN B. RAUM, *Commissioner.*

Hon. BEN. BUTTERWORTH,  
*House of Representatives.*